

IN RE: MERCER EXCAVATING, INC.) BK. # 88-30395
) Chapter 7
)
 Debtor)

Dennis W. Mercer (Mercer) seeks to allocate payments that will be made to the Internal Revenue Service (IRS) by the Chapter 7 trustee to trust fund tax liability before non-trust fund liability.

Mercer was the president and largest shareholder of the debtor in this case, Mercer Excavating, Inc. Mercer Excavating originally filed a petition for relief under Chapter 11 of the Bankruptcy Code. The case was later converted to Chapter 7.

126 U.S.C. 7501(a). [W]henever any person is required to collect or withhold any internal revenue tax from any other person and to pay over such tax to the United States, the amount of tax so collected or withheld shall be held to be a special fund in trust for the United States. The amount of such fund shall be assessed, collected, and paid in the same manner and subject to the same provisions and limitations as are applicable with respect to the taxes from which such fund arose.

personally liable for 100% of the tax if the employer fails to pay².

The debtor corporation withheld money from its employees but failed to pay the trust fund taxes for which it was intended. Mercer admits that he is personally liable as a "responsible person" under section 6672 for \$40,595.89 of trust fund taxes as of November 21, 1990.

The debtor also has non-trust fund tax liability of an undisclosed amount for which Mercer is not personally liable. Payments out of the bankruptcy estate towards the debtor's trust fund liability reduce Mercer's personal liability by an equal amount, but payments toward the debtors non-trust fund liability leave Mercer's personal liability intact. Consequently, Mercer requests this court to order the IRS to apply any payments made by the Chapter 7 trustee first to trust fund liability.

This court discussed the issue of allocation of payments to the IRS in the case, In re Arie Enterprises, Inc., 116 B.R. 641 (Bankr. S.D. Ill. 1990). Generally, "[w]hen a taxpayer makes voluntary payments to the IRS, he has a right to direct the application of [those] payments to whatever type of liability he chooses." 116 B.R. at 642-43. (citing Muntwyler v. United States, 703 F.2d 1030, 1032 (7th Cir. 1983)). However, "when a payment is involuntary, IRS policy is to

²26 U.S.C. 6672(a). Any person required to collect, truthfully account for, and pay over any tax imposed by this title who willfully fails to collect such tax, or truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over.

allocate the payment as it sees fit." Id.

In Muntwyler, payments made to the IRS under a common law assignment for the benefit of creditors were held to be voluntary and so had to be applied as directed by the taxpayer. That court distinguished an assignment for the benefit of creditors from a formal bankruptcy proceeding but did not decide whether payments under bankruptcy were voluntary. Id. at 1034 n. 2.

In Arie Enterprises, this court held that admonitions made by a bankruptcy court to a Chapter 11 debtor to pay post-petition taxes were sufficient court action to render those payments involuntary³. The facts in neither Muntwyler nor Arie Enterprises required a determination of whether payments made by a trustee under a Chapter 7 bankruptcy proceeding, without further court action, are voluntary. The present case requires a resolution of that issue.

In Muntwyler, the Seventh Circuit adopted the often cited definition of involuntary payment contained in Amos v. Commissioner, 47 T.C. 65, 69 (1966): "An involuntary payment of Federal taxes means any payment received by agents of the United States as a result of distraint or levy or from a legal proceeding in which the Government is seeking to collect its delinquent taxes or file claim therefor." 703

³In Arie, the payments at issue were made by the debtor under Chapter 11 before the case was converted to Chapter 7. The debtor had been warned twice by the court that failure to keep current on postpetition would result in dismissal of the case or conversion to a liquidation proceeding. There, determination of voluntariness was not as critical as in this case because the court held, alternatively, that the debtor could not direct the application of payments because it failed to make that direction at the time of the payments.

F.2d at 1032. That court distinguished voluntary from involuntary payments by "the presence of court action or administrative action resulting in an actual seizure of property or money as in a levy." 703 F.2d at 1033.

In Muntwyler, the determinative factor of voluntariness was the absence of court action. There, the IRS merely filed a claim with the assignee for the benefit of creditors. Payments of that claim were not rendered involuntary because they were not made pursuant to a levy, judicial order or execution by judicial sale.

In contrast, court action is present in a Chapter 7 bankruptcy proceeding by its nature. Commencement of a bankruptcy proceeding creates an estate which is comprised of all property of the debtor as of the commencement of the case. 11 U.S.C. section 541. Dividends are to be paid out of the estate to creditors at the times and amounts ordered by the court. See Bankruptcy Rules 3009 and 3010. Payments by a Chapter 7 trustee to the IRS are therefore involuntary and cannot be applied to any specific liability at the urging of the either the debtor or the responsible person under 26 U.S.C. section 6672.

Mercer argues that, even if involuntary, bankruptcy courts have the authority to direct application of payments to the IRS under United States v. Energy Resources Co., Inc., 495 U.S. ____, 110 S.Ct. 2139, 109 L.Ed. 2d 580 (1990). As this court pointed out in Arie Enterprises, the Energy Resources holding was narrow, allowing such action only "where necessary for the success of a reorganization plan." 110 S.Ct. at 2142. That holding has no application in this case because a Chapter 11 plan was never confirmed and the case has been

converted to Chapter 7. See Arie Enterprises at 643.

IT IS ORDERED that Dennis W. Mercer's Motion for Application of Funds Paid to Internal Revenue Service is DENIED.

/s/ Kenneth J. Meyers
U.S. BANKRUPTCY JUDGE

ENTERED: January 24, 1991